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C O N F I D E N T I A L SECTION 01 OF 02 SOFIA 000683

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TAGS: ECON PGOV PREL PTER BU
SUBJECT: BULGARIA TO CLOSE MONEY-LAUNDERING LOOP-HOLE, BUT EVEN GREATER TRANSPARENCY CHALLENGES AHEAD

REF: SOFIA 0122

Classified By: Ambassador Nancy McEldowney for reasons 1.4 (b) and (d).

¶1. (C) Summary: In response to intense lobbying by the Embassy (and later joined by the European Commission and several Bulgarian NGOs) the Bulgarians will close a long-standing loop-hole in financial reporting that was exploited to great effect by money launderers. The loop-hole allowed large sums of cash to go unreported -- and therefore uninvestigated -- in Bulgaria's largely cash-based economy. The Central Bank, backed by the banker's lobby and other politically-connected businesses and individuals, for years refused to close this gaping hole in Bulgarian anti-money laundering (AML) legislation. The country's politicians -- and their bankers -- finally gave in after the European Commission cited the loop-hole in its July Monitoring Report. This is the third success for the Embassy's self-styled rule of law taskforce in a year, after tax breaks for casinos were abandoned in December 2007 and the notorious duty free shops were closed in July 2008. We will now step up efforts on our next agenda item -- further shoring up Bulgaria's anti-money laundering infrastructure by restoring on-site inspection powers to the Financial Intelligence Directorate. End Summary.

THE SAGA OF CASH TRANSACTIONS

¶2. (C) For years money launderers have had it easy in Bulgaria. The country's anti-money laundering legislation required financial institutions to report cash transactions over 30,000 leva (19,000 USD) to the Financial Intelligence Directorate (FID). But in an intentional effort to create a loop-hole for those wishing to move large sums of cash through the Bulgarian banking system without detection, the form used to report these high value cash transactions did not include the actual amount of the transaction. In 2007, there were over 300,000 such transactions reported. But because the value of these transactions was not recorded, the FID was unable to distinguish between transactions of 30,000 or 3 million leva. The FID director, Vasil Kirov, identified this loop-hole as a key impediment to determining whether cash transactions merit further investigation.

¶3. (C) As part of its rule of law pressure campaign, Embassy leadership and action officers raised the cash transaction issue with the Bulgarian Government at all levels for more than a year. We reached out to other Embassies, civil society experts, the Banker's Association, and private individuals, urging them to join forces to close the loop-hole. When the idea met strong Bulgarian government resistance, we made in-roads with the drafters of the EU monitoring reports in Brussels. They included it in their July Monitoring Report on Bulgaria, using our points nearly word for word.

¶4. (C) Eager to answer the criticism of the EU's stinging report and desperate to regain the EU's confidence in the government's ability to manage EU funds, in August Bulgaria issued an 80-point action plan keyed to concerns in the EU's July Report. Included was a promise to close the cash transactions reporting loop-hole by mid-October. Even after inclusion in the action plan, our contacts tell us the Central Bank put up stiff resistance to closing the loop-hole. After realizing it was fighting a losing battle, it acquiesced. On October 21, the Central Bank Governor and Head of the State Agency for National Security signed a joint instruction introducing a new form for recording of cash transactions over 30,000 leva. The new form includes the amount of the transaction. The joint instruction will be implemented beginning January 1, 2009. There are certain strings attached -- the forms must be destroyed after five years (the Central Bank had argued for six months) and the FID must explain to a Parliamentary oversight committee how it uses the information it gathers from these forms each year -- but otherwise the new form is a true improvement in Bulgaria's anti-money laundering regime.

THE WORK AHEAD

¶5. (C) With the money laundering loop-hole soon to close, we will turn our attention to other gaps in Bulgaria's anti-money laundering regime. We will focus first on lobbying the government to restore on-site inspection powers the FID lost when it became part of the newly-created State Agency for National Security in early 2008. By stripping the

FID of these powers, the Central Bank is now the only entity able to overcome banking secrecy rules to perform unannounced on-site AML-related bank inspections. But there is evidence that the Central Bank is not interested in conducting such investigations, and, as a result, no AML investigations are being conducted in Bulgaria at present. We will include this serious hole in Bulgaria's AML regime in our next INCSR-II report. We'll also urge the European Commission to include it in its next report on Bulgaria, due February 2008.

¶6. (C) We will also focus on other weak links in Bulgarian's AML regime. We will urge Bulgaria to adopt a cross-border currency declaration requirement and include withdrawals in the list of cash transactions which must be reported to the FID if they are over 30,000 leva (according to the head of the FID, currently only deposits are required to be reported). We will also advocate for a doubling of FID inspectors (to 24 from the current 12) and urge a reporting requirement showing that Bulgarian AML inspectors are performing a minimum number of inspections per month. We'll lobby for an increase in sanctions against banks -- and there are many -- that do not file suspicious transaction reports.

COMMENT

¶7. (C) If the multi-year, multi-party effort it took to close the cash transactions reporting loophole is any indication, we are in for a tough fight as we move forward on our next rule of law/AML agenda items. One disturbing aspect of the battle is the aggressiveness with which the Central Bank and banking lobby fight needed improvements in Bulgaria's AML regime. Even more disturbing is the blatant passivity of the Bulgarian Government in the face of obvious need for additional reform. From the outside, this seemingly coordinated passive/aggressive approach lends the impression that the Government is still intent on protecting well-connected individuals who benefit from Bulgaria's AML loop holes and weak rule of law regime. Our efforts on tax breaks for casinos, duty free shops and now cash transactions prove that coordinated Embassy, civil society and European

Commission action can affect genuine change on individual issues. But true progress will come only when Bulgarians spear-head it themselves. We'll keep helping those Bulgarians who want precisely that.

McEldowney